Supreme Court, U.S.
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MICHAEL RODAK, JR.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

NO. 79-1552

ALABAMA DEPARTMENT OF REVENUE and CHARLES A. BOSWELL, as Commissioner of Revenue, State of Alabama,

Petitioner

v.

JOHN DAVID FOX, JR., formerly d/b/a CHEROKEE CONSTRUCTION CO. and CHEROKEE WOODWORK & SUPPLY CO.,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FIFTH CIRCUIT

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April 3, 1980

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Federal Statute Involved	2
Statement of the Case	3
Reasons for Granting the Writ	5
Conclusion	10
Proof of Service	11
Appendix A	12
Appendix B	18
Appendix C	25
Appendix D	35

CITATIONS

United States v. Sotelo, 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed2d 275 (1978) 2, 5, 6, 7, 8, 9

Matter of Fox, 609 F.2d 178 ..... 5, 6, 7

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FIFTH CIRCUIT

The Petitioner, Alabama Department of Revenue, prays that a Writ of Certiorari issue to review the opinion and judgment of the United States Court of Appeals, Fifth Circuit, entered January 4, 1980.

OPINIONS BELOW

The opinion of the trial court, the Bankruptcy Court for the United States District Court, Northern District of Alabama entered May 20, 1977, is unreported and appears at Appendix A, infra, p. 12. The opinion of

the United States District Court, Northern District of Alabama, Southern Division, is unreported and appears at Appendix B, infra, p. 18. The opinion of the United States Court of Appeals, Fifth Circuit, is reported at 609 F.2d 178, and appears as Appendix C, infra, p. 25.

JURISDICTION

The judgment of the United States Court of Appeals, Fifth Circuit, was rendered on January 4, 1980, 609 F.2d 178. This Petition for Certiorari was filed within 90 days from the date aforesaid. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1), in a civil case after rendition of judgment by the United States Court of Appeals, Fifth Circuit.

QUESTIONS PRESENTED

Has the United States Court of Appeals, Fifth Circuit, reached a decision in conflict with the prior decision of the Supreme Court of the United States in United States v. Sotelo, 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978)?

Do the sales taxes involved in this action constitute taxes which the Bankrupt collected or withheld from others within the ambit of 11 U.S.C. §35(a)(1)(e)?

FEDERAL STATUTE INVOLVED

This case involves §17a(1)(e) of the Bankruptcy Act, codified at 11 U.S.C. §35(a)(1)(e), which provides:

> "A discharge in bankruptcy shall release a Bankrupt from all his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the Bankrupt to the

"United States or to any State or any subdivision thereof within three years preceeding bankruptcy: Provided, however, that a discharge in bankruptcy shall not release a Bankrupt from any taxes . . . .(e) which the Bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . . ."

STATEMENT OF THE CASE

The Bankrupt Appellee, John David Fox, Jr., filed a Petition for Bankruptcy in the United States District Court, Northern District of Alabama, on October 14, 1971. The State of Alabama filed a Proof of Claim on November 22, 1971. An Order of Discharge was entered by the Bankruptcy Court on February 3, 1972. A Complaint to Obtain a Determination was filed by the Bankrupt, John David Fox, Jr., on April 15, 1976, and an Order Reopening the Bankruptcy was issued on April 15, 1976. On May 12, 1976, the Bankrupt filed an Amendment to Plaintiff's Complaint. The State of Alabama filed an Answer to the Plaintiff's Complaint on June 9, 1976. On February 8, 1977, the parties submitted a Joint Stipulation of Facts. On February 15, 1977, the Bankruptcy Court issued a Pretrial Hearing Memorandum reciting an additional Stipulation of Facts. On May 20, 1977, the Bankruptcy Court entered a Judgment for the State of Alabama, Department of Revenue, along with a Statement of the Case, Findings of Facts, and Conclusion by the Court. From the Judgment of the Bankruptcy Court, the State of Alabama, Department of Revenue, filed a Notice of Appeal to the United States District Court, Northern District of Alabama, Southern Division, on May 31, 1977. The case was submitted to the District Court on briefs by both parties. On September 20, 1977, the

District Court entered an Order in favor of the Bankrupt along with a Memorandum Opinion reciting the findings and conclusions of the Court. On October 19, 1977, the State of Alabama, Department of Revenue, filed a Notice of Appeal with the United States Court of Appeals, Fifth Circuit. The case was submitted to the United States Court of Appeals, Fifth Circuit, on briefs and oral arguments by the parties. On January 4, 1980, the United States Court of Appeals, Fifth Circuit, entered a Judgment affirming the decision of the United States District Court.

This case was originally submitted to the Bankruptcy Court on a Stipulation of Facts signed by both parties, and written briefs. The Stipulation of Fact is attached as Appendix D, infra, p. 35. The Bankrupt, John David Fox, Jr., filed a Petition in Bankruptcy on October 14, 1971, and was adjudicated a Bankrupt and discharged on February 3, 1972. The Bankrupt filed sales tax returns with the Alabama Department of Revenue for each and every month beginning January 1, 1966 and ending August 31, 1969, as a result of engaging in the business of selling tangible personal property at retail in Alabama. On October 29, 1969, the Department of Revenue audited the books and records of the Bankrupt. The Bankrupt did not object to the correctness of the examination. The audit revealed that the Bankrupt had understated and failed to report an additional sales tax amount due and owing the State of Alabama of $3,439.27. On November 7, 1969, a Final Assessment of Sales Tax was entered against John David Fox, Jr., in the amount of $4,331.15. The amount in controversy between the parties is $4,331.15 less $300.00 the Bankrupt admitted was due and owing the State of Alabama, and which the Bankruptcy Court adjudged to be nondischargable.

The basis for jurisdiction of the original Federal Court of first instance is pursuant to §17(c)(1) of the Bankruptcy Act codified at 11 U.S.C. §35(c)(1) and Bankruptcy Rule 409(a)(1).

REASONS FOR GRANTING THE WRIT

In its Opinion the United States Court of Appeals, Fifth Circuit, held:

> "The stipulation does not specifically address to whether the taxes were in fact collected, the appellee merely concedes that he is indebted for that amount. Under Alabama law appellee is obligated to collect and 'owes' the sales taxes whether he actually collected same or not. The most difficult part of the instant inquiry is whether the nondischarge hammer falls only as to taxes which in fact were collected (or withheld) or falls equally upon those collected and those which should have been collected. It may be suggested that this question is dispositively resolved by the holding in United States v. Sotelo, 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978). We recognize one might conclude the rationale and language of that decision mandates a reversal herein denying a discharge for the entirey of the taxes at issue without regard as to whether same were in fact collected or not. We do not read the decision to require that result, for in Sotelo the facts reflected that the taxes at issue had been withheld but not remitted."
> Matter of Fox, 609 F.2d at 182.

The State of Alabama, Department of Revenue, respectfully submits that the decision

of the United States Court of Appeals, Fifth Circuit, in the instant case is directly in conflict with the prior decision of the Supreme Court of the United States as evidenced in United States v. Sotelo, supra. The United States Court of Appeals, Fifth Circuit, held in the present case that:

> "We must now finally consider whether the appellee has in fact or by operation of law 'collected . . . from others . . . but has not paid over' the contested sales tax. Pertinent thereto is the following excerpt from the Alabama sales tax statute:
>
> > 'All taxes paid in pursuance to this article or any statute enacted in this connection shall conclusively be presumed to be a direct tax on the retail consumer, pre-collected for the purpose of convenience and facility only. Title 51, Section 786(25), Code of Alabama 1940, recompiled 1958.'
>
> "The stipulation does not specifically address to whether the taxes were in fact collected, the appellee merely concedes that he is indebted for that amount. Under Alabama law appellee is obligated to collect and 'owes' the sales taxes whether he actually collected same or not."
> Matter of Fox, 609 F.2d at 181.

From the above-quoted portion of the decision in the present case, it is clear the Fifth Circuit Court of Appeals considered the question of whether or not the Bankrupt had in fact or by operation of law collected a tax from others but had not paid it over to the State to be the question of ultimate impor-

tance. It is also apparent that when the Fifth Circuit Court of Appeals ruled that "Under Alabama law appellee is obligated to collect and 'owes' the sales tax whether he actually collected same or not" to be a determination that the Bankrupt had collected from others by operation of law a tax due and owing the State of Alabama. However, the finding by the United States Court of Appeals, Fifth Circuit, that:

> "We conclude that the proper interpretation of §17a(1)(e), consistent with the intent of the Bankruptcy Act and the legislative historicity of the section, prohibits discharge in bankruptcy only for sales taxes actually collected or withheld and not remitted. To the extent the debtor merely failed to acquit a statutory duty and collect taxes he discharged.
>
> "From the record before us it is not possible to ascertain what portion of the sums at issue, if any, were actually collected. As to this issue, the presumption in favor of the State of Alabama referred to above is not sufficient. There must be proof of actual collection, dehors a statutory presumption. That burden of proof is upon ADR who resists the discharge. Appellant has failed to meet the burden of proof on this issue. Accordingly, for the reasons herein assigned, the judgment of the District Court as to the result it reached is AFFIRMED."
> Matter of Fox, 609 F.2d at 182.

In the case of United States v. Sotelo, the Statement of Facts recited by the United States Supreme Court included the finding:

> "The court concluded that Onofre Sotelo was personally liable to the Government under Internal Revenue Code, §6672, since he 'was charged with the duty and responsibility to see that the [withheld] taxes were paid.'"
> 98 S.Ct. 1795 at 1798.

The State believes that the fact that the Fifth Circuit Court of Appeals found that the Bankrupt was liable for sales taxes due and owing the State of Alabama under Title 51, §786(25), Code of Alabama 1940, recompiled 1958, and that "Under Alabama law the appellee is obligated to collect and 'owes' the sales taxes whether he actually collected same or not", would mandate a finding that the debt for sales taxes due and owing the State of Alabama was nondischargable in light of the decision of the United States Supreme Court in the case of United States v. Sotelo. In the Sotelo case, the Supreme Court of the United States held:

> "The fact that the respondent was found liable under §6672 necessarily means that he was 'required to collect, truthfully account for, and pay over' the withholding taxes, and that he willfully failed to meet one or more of these obligations. IRC §6672; see n. 1, supra. Since the §6672 'require[ment]' of collection presumably derives from Federal or State law, both of which are referred to in Bankruptcy Act, §17a(1)(e), it is difficult to understand how the Court below could have recognized respondent's §6672 liability, see pp. 1798-1799, supra, and nonetheless have concluded that he was not 'obligated by law to collect . . . the taxes, . . .' 551 F.2d at 1092. It is undisputed

"here, more over, that the taxes in question were 'collected or withheld' from the corporation's employees and that the taxes, though collected, have not been 'paid over' to the Government. It is therefore clear that the §6672 liability was not imposed for a failure on the part of respondent to collect taxes, but was rather imposed for his failure to pay over taxes that he was required both to collect and to pay over. Under these circumstances the most natural reading of the statutory language leads to the conclusion that respondent 'collected or withheld' the taxes within the meaning of Bankruptcy Act, §17a(1)(e)." (Emphasis added.)

United States v. Sotelo, 98 S.Ct. 1795 at 1799 and 1800.

The State of Alabama respectfully submits that the situation in the present cause and the situation in the Sotelo case, supra, is exactly the same. In the present case, the United States Fifth Circuit Court of Appeals concluded that the Taxpayer-Bankrupt was "obligated by law to collect sales taxes and owes the sales taxes whether he actually collected same or not." The State of Alabama submits that the Sotelo holding of the United States Supreme Court makes it clear that the liability for the sales taxes is not imposed for a failure on the part of the taxpayer to collect the taxes, but was imposed for the taxpayer's failure to pay over the taxes that he was required both to collect and to pay over.

In addition, the State of Alabama, Department of Revenue would point out that the United States Court of Appeals, Fifth Circuit, recognized that Title 51, §786(25) presumed that the sales taxes involved in the present action are presumed to be pre-collected by

operation of law. Under these circumstances, the State of Alabama submits that the holding of this Honorable Court mandates a finding by the United States Court of Appeals, Fifth Circuit, that the sales taxes in question in the present cause were "collected" or withheld within the meaning of the Bankruptcy Act's §17a(1)(e).

CONCLUSION

Based on the foregoing discussion of the authorities and the facts, the State of Alabama respectfully requests the United States Supreme Court issue its Writ of Certiorari directed to the United States Court of Appeals, Fifth Circuit, and that upon a review of the record the State of Alabama prays that this Honorable Court will direct the United States Court of Appeals, Fifth Circuit, to hold that the sales taxes collected from another by the taxpayer-bankrupt and presumed by operation of Alabama law to be collected constitute taxes subject to the provisions of the Bankruptcy Act, §17a(1)(e) and thus constitute a nondischargable debt.

Respectfully submitted,

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COUNSEL FOR PETITIONER

PROOF OF SERVICE

I, John J. Breckenridge, of Counsel for Petitioner State of Alabama, Department of Revenue and a member of the Bar of the Supreme Court of the United States, certify that I have served a copy of the foregoing Petition for Writ of Certiorari on the Honorable Herbert D. Jones, Jr., P. O. Box 1618, Anniston, Alabama, Counsel for Respondent John David Fox, Jr., by placing same in the United States mail, postage prepaid on this the 3rd day of April, 1980.

JOHN J. BRECKENRIDGE

OF COUNSEL FOR PETITIONER

In the Matter of John David FOX, Jr., etc. Bankrupt.

ALABAMA DEPARTMENT OF REVENUE and Charles A. Boswell as Commissioner of Revenue, State of Alabama, Appellants,

v.

John David FOX, Jr., Formerly d/b/a Cherokee Construction Company and Cherokee Woodwork and Supply Company, Appellee.

No. 77-3144.

United States Court of Appeals, Fifth Circuit.

Jan. 4, 1980.

Alabama Department of Revenue appealed from a decision of the United States District Court for the Northern District of Alabama, at Birmingham, Clarence W. Allgood, J., approving bankruptcy court order discharging the bankrupt from paying sales taxes and penalties. The Court of Appeals, Politz, Circuit Judge, held that: (1) Bankruptcy Act's nondischarge provision for taxes "* * * (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat" covers a deliberate act calculated to defraud, not a simple error which renders a tax return "false"; (2) Bankruptcy Act provision that "* * * a discharge in bankruptcy shall not release a bankrupt from any taxes * * * (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over" applies to Alabama sales taxes, not just social security taxes and income taxes; (3) Bankruptcy Act prohibits discharge only for sales taxes actually collected or withheld and not remitted; and (4) the Department of Revenue failed to meet its burden of proving, as a condition precedent to nondischargeability, what sales taxes had actually been collected or withheld and not remitted.

Affirmed.

1. Bankruptcy ⇐422

Bankruptcy Act's nondischarge provision for taxes "* * * (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat" covers a deliberate act calculated to defraud, not a simple error which renders a tax return "false." Bankr.Act, § 17(a)(1)(d), 35 U.S.C.A. § 35(a)(1)(d).

2. Taxation ⇐204(2)

One seeking to assert an exemption from taxation has the burden to clearly establish such right, and in all cases of doubt as to legislative intent, the presumption is in favor of the taxing power.

3. Taxation ⇐1316

Taxpayer had the burden of proving that sales from his retail business fit within one of the articulated exemptions to sales tax liability. Bankr.Act, § 17(a)(1)(d, e), 35 U.S.C.A. § 35(a)(1)(d, e).

4. Bankruptcy ⇐422

Bankruptcy Act provision that "* * * a discharge in bankruptcy shall not release a bankrupt from any taxes * * * (e) which the bankrupt has collected or withheld from others as required by the laws of the United

States or any State or political subdivision thereof, but has not paid over" applies to Alabama sales taxes, not just social security taxes and income taxes. Bankr.Act, § 17(a)(1)(e), 35 U.S.C.A. § 35(a)(1)(e).

5. Bankruptcy ⇐422

Bankruptcy Act prohibits discharge only for sales taxes actually collected or withheld and not remitted; to the extent the debtor merely failed to acquit a statutory duty and collect taxes, he is discharged. Bankr.Act, § 17(a)(1)(e), 35 U.S.C.A. § 35(a)(1)(e).

6. Bankruptcy ⇐436(3)

Alabama Department of Revenue, resisting the discharge in bankruptcy of sales taxes, failed to meet its burden of proving, as a condition precedent to nondischargeability, what sales taxes had actually been collected or withheld and not remitted. Bankr.Act, § 17(a)(1)(e), 35 U.S.C.A. § 35(a)(1)(e).

Appeal from the United States District Court for the Northern District of Alabama.

Before GODBOLD, HILL and POLITZ, Circuit Judges.

POLITZ, Circuit Judge.

This case presents the question whether sales taxes admittedly owed to the Alabama Department of Revenue (ADR) by appellee are discharged in bankruptcy or remain due under the nondischarge provisions of § 17a(1) of the Bankruptcy Act, 11 U.S.C. § 35(a)(1).

ADR appeals a district court decision which approves a bankruptcy court order discharging the appellee-bankrupt, John David Fox, Jr., from paying Alabama sales taxes[1] and penalties assessed at $4,031.15 for the period from January 1

1. Title 51, § 786(25), *Code of Alabama* 1940, Recompiled 1958, reads as follows:

> Every person, firm, corporation, association, or co-partnership engaged in or continuing within this state in the business for which a license or privilege tax is required by this Article shall add to the sales price and collect from the purchaser on all sales upon the gross receipts or gross proceeds of which there is levied by this Article a sales tax at the rate of four percent, four cents tax for each whole dollar of sales price; provided, however, on that part of the sales price which is a fractional part of a dollar, in addition to whole dollars, and on sales of less than a dollar there shall be collected in addition to the tax collected on whole dollars, no tax on one cent to and including ten cents of sales price, one cent tax on eleven cents to and including thirty cents of sales price, two cents tax on thirty-one cents to and including fifty-four cents of sales price, three cents tax on fifty-five cents to and including seventy-three cents of sales price, and four cents tax on seventy-four cents to and including ninety-nine cents of sale price. Upon all sales the gross receipts or gross proceeds of which are taxed by this article at a rate less than four percent there shall be added to the sales price and collected from the purchaser by such person, firm, corporation, association, or co-partnership described in this section an amount equal to the prescribed percentage of such sales price. It shall be unlawful for any person, firm, corporation, association, or co-partnership described in this section to fail or refuse to add to the sales price and collect from the purchaser the amount required by this section to be so added to the sales price and collected from the purchaser; and it shall likewise be unlawful to refund or offer to refund all or any part of the amount collected, or to absorb or advertise directly or indirectly the absorption or refund of the amount required to be added to the sales price and collected from the purchaser, or any portion of such amount. Any person, firm, corporation, association, or co-partnership violating any of the provisions of this section shall be guilty of a misdemeanor and

1966 through August 31, 1969.[2] Appellants challenge the district court's holding that neither § 17a(1)(d) nor 17a(1)(e) prevents the discharge. We agree that § 17a(1)(d) does not apply to the instant factual situation. However, we do not agree with the district court's conclusions that § 17a(1)(e) is inapplicable.

Section 17a(1) of the Bankruptcy Act, 11 U.S.C. § 35(a)(1), provides in pertinent part as follows:

> A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes . . . (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . .

[1] ADR concedes that the sales taxes in question became legally due and owing more than three years preceding bankruptcy.[3] This would conclude our consideration but for the exceptions noted in subsections (d) and (e).

ADR asserts applicability of subsection (d) on the grounds that the tax returns filed were false. No fraud is claimed, to the contrary the parties have stipulated that none exists. The district court held that subsection (d) does not prevent discharge, holding that "false" as used in subsection (d) was intended to cover a deliberate act calculated to defraud, not a simple error as stipulated herein. A false return is something more than an incorrect return. We agree.

The essential questions we note are: (1) does § 17a(1)(e) apply to state sales taxes, and (2) has appellee actually collected sales taxes and failed to remit to the state?

This case was tried on a very brief stipulation of facts. Noting that appellee's sales might have consisted of tax

upon conviction shall be fined in a sum of not less than fifty dollars nor more than one hundred dollars, or may be imprisoned in the county jail for not more than six months or by both such fine and imprisonment, and each act in violation of the provisions of this article shall constitute a separate offense. The provisions of this section that there shall be added to the sales price and collected from the purchaser the amounts provided herein shall in no way relieve the person, firm, corporation, association or co-partnership described in this section of the tax levied by this article, nor shall the inability, impracticability, refusal, or failure to add to the sales price and collect from the purchaser the amounts provided herein relieve such person, firm, corporation, association, or co-partnership from the tax levied by this article. All taxes paid in pursuance to this article or any other statute enacted in this connection shall conclusively be presumed to be a direct tax on the retail consumer, pre-collected for the purpose of convenience and facility only.

2. Sales taxes remained unpaid from January 1, 1966, through December 31, 1968. The total charge to Fox was $4,331.45. However, since the bankrupt agrees that his discharge does not bar collection of $300 in sales taxes due between October 14, 1968 and December 31, 1968, the sum presently at issue is $4,031.15.

3. The district court held that the taxes in question became legally due and owing more than three years prior to the bankruptcy. ADR does not dispute this determination on appeal.

exempt items, an issue not addressed in the stipulation, the district court concluded that ADR failed to carry the burden of proof that the taxes were owed by the bankrupt.

[2, 3] We disagree with this threshold conclusion, for it overlooks the well settled Alabama rule that "one seeking to assert an exemption from taxation has the burden to clearly establish such right, and in all cases of doubt as to legislative intent, the presumption is in favor of the taxing power." *Title Guarantee Loan & Trust Co. v. Hamilton*, 238 Ala. 602, 192 So. 107 (1940); *State v. Bankhead Mining Company*, 279 Ala. 566, 188 So.2d 527 (1966). According to this rule, appellee had the burden of proving that sales from his retail business[4] fit within one of the articulated exemptions. Not only has appellee failed to meet this burden, he has stipulated that he did not report an additional sales tax amount due and owing the State of Alabama for $3,439.27.[5] Under these circumstances, we are compelled to the conclusion that the burden of proof is not upon ADR, as maintained by the district court, but as relates to this issue the burden is upon Mr. Fox. He has not carried that burden. As further noted herein, however, this is only a threshold consideration.

[4] The district court further concluded that § 17a(1)(e) applies only to social security taxes and income taxes and has no application to Alabama sales taxes. We find such a restrictive application inconsistent with the language and the legislative history of § 17a(1).[6]

The district court was apparently of the opinion that the primary responsibility for payment of the Alabama sales tax is upon the seller and not the purchaser. The Alabama Supreme Court has declared the "ultimate burden" of the sales tax is on the consumers, not the sellers. *Ross Jewelers v. State*, 260 Ala. 682, 72 So.2d 402 (1953); *Merriwether v. State*, 252 Ala. 592, 42 So.2d 465 (1949). Therefore, the tax at issue is one which is collected from third parties. Further, a mandatory duty is imposed on the seller to collect and remit the Alabama sales tax to the sale. *Alabama v. King & Boozer*, 314 U.S. 1, 86 L.Ed. 3, 62 S.Ct. 43 (1941); *Doby v. State Tax Commission*, 234 Ala. 150, 174 So. 233 (1937). We hold that the Alabama sales tax is a tax within the ambit of § 17a(1)(e).

We must now finally consider whether the appellee has in fact or by operation of law "collected . . . from others . . . but has not paid over" the contested sales tax. Pertinent thereto is the following excerpt from the Alabama sales tax statute:

> All taxes paid in pursuance to this article or any statute enacted in this connection shall conclusively be presumed to be a direct tax on the retail

4. Stipulation No. 2 is to the effect that appellee was engaged in the business of selling tangible personal property at retail in Alabama from January 1, 1966 to August 31, 1969.

5. Stipulation No. 4. Figure presented above represents taxes due before penalty assessment.

6. One of the primary purposes of the 1966 amendments, after years of congressional consideration, was to establish a three year limitation on nondischargeable taxes, generally, except for those made fully nondischargeable by the provisions of § 17a(1)(d) and (e). See H.R. Rep. No. 372, 88th Cong., 1st Sess., 1–3 (1963); S.Rep. No. 114, 89th Cong., 1st Sess., 2–3 (1965). We find no basis for limiting the exempted taxes to income taxes, social security taxes and unemployment insurance taxes as held by the district court.

consumer, pre-collected for the purpose of convenience and facility only. Title 51 § 786(25), *Code of Alabama* 1940, Recompiled 1958.

The stipulation does not specifically address to whether the taxes were in fact collected, the appellee merely concedes that he is indebted for that amount. Under Alabama law appellee is obligated to collect and "owes" the sales taxes whether he actually collected same or not. The most difficult part of the instant inquiry is whether the nondischarge hammer falls only as to taxes which in fact were collected (or withheld) or falls equally upon those collected and those which should have been collected. It may be suggested that this question is dispositively resolved by the holding in *United States v. Sotelo*, 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978). We recognize one might conclude the rationale and language of that decision mandates a reversal herein denying a discharge for the entirety of the taxes at issue without regard as to whether same were in fact collected or not. We do not read the decision to require that result, for in *Sotelo* the facts reflected that the taxes at issue had been withheld but not remitted.

Believing the opinion should be viewed in light of the controlling facts we conclude that *Sotelo* is not dispositive of the essential issue herein.

It cannot be gainsaid that the purpose of the Bankruptcy Act is to allow a fresh start to the bankrupt. As noted in the S.Rep. No. 1158, 89th Cong., 2nd Sess., 1966, "The fundamental policy of the Bankruptcy Act is to provide a means for (1) the effective rehabilitation of the bankrupt and (2) the equitable distribution of his assets among his creditors." Our courts have long recognized this. For example, see *Perez v. Campbell*, 402 U.S. 637, 648, 91 S.Ct. 1704, 1710–1711, 29 L.Ed.2d 233 (1971):

> This Court on numerous occasions has stated that "[o]ne of the primary purposes of the bankruptcy act" is to give debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, [54 S.Ct. 695, 699, 78 L.Ed. 1230] (1934). Accord, e. g., *Harris v. Zion's Savings Bank & Trust Co.*, 317 U.S. 447, 451 [63 S.Ct. 354, 357, 87 L.Ed. 390] (1943); *Stellwagen v. Clum*, 245 U.S. 605, 617, [38 S.Ct. 215, 218, 62 L.Ed. 507] (1918); *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554–555 [, 35 S.Ct. 289, 290, 59 L.Ed. 713] (1915).

Consistent with this we are constrained to hold that the denial of the discharge under § 17a(1)(e) extends only to sums *actually* collected or withheld, for there we have an improper animus. We do not assign that same animus to the situation where the civil liability automatically attaches for taxes which are not collected or withheld short of a situation covered by § 17a(1)(d).[7]

[5] We conclude that the proper interpretation of § 17a(1)(e), consistent with the intent of the Bankruptcy Act and the legislative historicity of the section, prohibits discharge in bankruptcy only for sales taxes *actually* collected or withheld and not remitted. To the extent the debtor merely failed to acquit a

7. We do not mean to exclude a denial of the discharge under 17a(1)(d) where a willful attempt to evade or defeat taxes by intentional failure to collect or withhold is shown.

statutory duty and collect taxes he is discharged.[8]

[6] From the record before us it is not possible to ascertain what portion of the sums at issue, if any, were actually collected. As to this issue, the presumption in favor of the State of Alabama referred to above is not sufficient. There must be proof of actual collection, dehors a statutory presumption. That burden of proof is upon ADR who resists the discharge.[9] Appellant has failed to meet the burden of proof on this issue. Accordingly, for the reasons herein assigned, the judgment of the district court as to the result it reached is

AFFIRMED.

8. Subject, of course, to the provisions of 17a(1)(d) which bar discharge for taxes which one willfully failed to collect or withhold in order to evade or defeat same.

9. *Connelly v. Michael*, 424 F.2d 387 (5th Cir. 1970); *Rice v. Matthews*, 342 F.2d 301 (5th Cir. 1965); see also 1A *Collier on Bankruptcy*, ¶ 14.12 (14th ed. 1978).

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA

In re

JOHN DAVID FOX, JR.
(FORMERLY D/B/A CHEROKEE CONSTRUCTION COMPANY AND CHEROKEE WOODWORK AND SUPPLY COMPANY),

Bankrupt.

Bankruptcy No. 12780-E

JOHN DAVID FOX, JR.,

Plaintiff,

v.

ALABAMA DEPARTMENT OF REVENUE and CHARLES A. BOSWELL, AS COMMISSIONER OF REVENUE, STATE OF ALABAMA,

Defendants.

JUDGMENT

Pursuant to the findings, conclusions, and order entered today in the above-styled adversary proceeding, it is ORDERED by the Court that the State of Alabama (State Department of Revenue) have and recover the sum of $300.00 from the plaintiff, John David Fox, Jr., that judgment is hereby rendered in favor of the State of Alabama (State Department of Revenue) and against the said John David Fox, Jr. for said sum of $300.00, with lawful interest thereon from this day to the date of payment, together with lawful costs and expenses incident to the collection thereof (including the lawful expenses and fees of United States Marshals), and that execution and other writs of Court may issue in aid of the collection of this judgment.

Done at Anniston, Alabama, on this May 20, 1977.

L. CHANDLER WATSON, JR.
Bankruptcy Judge

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA

In re

JOHN DAVID FOX, JR.
(FORMERLY D/B/A CHEROKEE
CONSTRUCTION COMPANY AND
CHEROKEE WOODWORK AND
SUPPLY COMPANY),

Bankrupt.

Bankruptcy No. 12780-E

JOHN DAVID FOX, JR.,

Plaintiff,

v.

ALABAMA DEPARTMENT OF REVENUE
and CHARLES A. BOSWELL, AS
COMMISSIONER OF REVENUE,
STATE OF ALABAMA,

Defendants.

STATEMENT OF THE CASE

The plaintiff, John David Fox, Jr., filed a voluntary petition in bankruptcy on October 14, 1971, and an order was entered February 3, 1972, discharging said bankrupt from his dischargeable debts. Among the creditors listed in his schedule of debts was "State Department of Revenue, Montgomery, Alabama". This case was closed December 30, 1974, and was reopened April 15, 1976, on application of the plaintiff-bankrupt; whereupon, he filed a complaint, seeking to have this Court adjudicate that a claim by the State of Alabama, for sales taxes (plus penalty and interest) was barred by his discharge in bankruptcy and that a writ of garnishment for collection of this debt be "quashed". The State filed an answer, setting up two defenses:

1. The debt represents taxes for which a final assessment was made within three years preceding bankruptcy, bringing it within an exception to the discharge of taxes which became legally due and owing by the bankrupt to the State within three years preceding bankruptcy; and

2. The debt represents sales taxes collected by the bankrupt from parties who made purchases from him and falls within an exception from the discharge of taxes collected or withheld from

others as required by the laws of the State but which were not paid over to it.

The taxes were assessed as a result of an audit by the State of the bankrupt's books, concluded October 29, 1969. The audit covered the period from January 1, 1966, through August 31, 1969, but it was determined that no additional tax was owed for the period after December 31, 1968. The final assessment, including penalties and interest, was for $4,331.15, the sum of the additional taxes being $3,439.27. The bankrupt did not then, and does not now, dispute the accuracy of the assessment. The State does not contend that the bankrupt's sales tax returns were fraudulent or that he made a deliberate attempt to defraud the State of its taxes.

The bankrupt has conceded that the discharge in bankruptcy does not bar collection of sales taxes for the period beginning October 14, 1968, and running through the end of that year; and the bankrupt and the State have agreed that the amount which he owes for this period is $300.00. The case was submitted to the Court for a decision, upon the complaint, the answer, a stipulation of facts, and the briefs of the parties. In its brief, the State raises a contention for the first time that the bankrupt filed a false return. The contention in the brief is that the bankrupt's sales tax returns were determined not to be correct and thereby are false and that the debt falls within an exception to the discharge of taxes with respect to which the bankrupt "made a false or fraudulent return, or willfully attempted in any manner to evade or defeat".

Findings of Fact

There is no dispute as to the facts in this case. The bankruptcy judge finds, from the uncontradicted pleadings and from the stipulation of facts, the facts in this case to be as hereinabove stated.

Conclusions by the Court

As indicated by its title, §17 of the Bankruptcy Act[1] enumerates the "Debts Not Affected by a Discharge". The first exception is

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[1] 11 U.S.C. §35.

for taxes which became legally due and owing within three years preceding bankruptcy. Prior to an amendment in 1966, all taxes were not affected by a discharge. It is stated in Collier on Bankruptcy that the report by the Senate Finance Committee pointed out that this amendment did not define when taxes became due and owing and suggested that the wording should be altered so as to make the time period run from the date of assessment but that the report was not adopted by the Senate; and the suggestion is made that the terminology should be interpreted to mean when the tax return is due.[2]

In the present case, Code of Alabama, Title 51, §786(6) provides that the sales taxes "shall be due and payable in monthly installments on or before the twentieth day of the month next succeeding the month in which the tax accrues" and that the sales tax "statement" or return is due at the same time. It further states that the person making the report shall compute "the taxes due and shall pay to the Department of Revenue the amount of taxes shown to be due".

A plain and easy reading of the Alabama statute shows that the sales taxes accrued during August 1968 became due and payable September 20, 1968, and that the sales taxes accrued during September 1968 became due and payable October 20, 1968. October 13, 1968, being exactly three years preceding the bankruptcy, it appears that the sales taxes which accrued for August 1968 and earlier months are beyond the three years mentioned in §17a(1) of the Bankruptcy Act and that the taxes which accrued for the months of September through December 1968 are within the three years and are, therefore, not dischargeable in bankruptcy.

The State contends that the additional taxes owed by the bankrupt were not due until the State made a final assessment of them against the bankrupt, with this occurring on a date within the three years preceding bankruptcy. This involves a strained construction of both the Alabama and the Federal statutes. Any additional tax assessed was attributable to sales made by the

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[2] ¶17.14, pp. 1614-15 (14th ed., rel. nos. 11-1971 & 17-1973).

bankrupt during a particular month, and those additional taxes with the taxes actually paid by the bankrupt constituted the correct sum of taxes for that month and this sum was due and payable on the twentieth day of the succeeding month; therefore, the date of the final assessment is irrelevant, and this contention by the State is rejected by the Court.

There is no evidence to sustain the second defense asserted by the State, to the effect that the debt represents taxes collected or withheld from others and not paid over to it. Any creditor who asserts that his claim against the bankrupt is not affected by the discharge of the bankrupt has the burden of proving this exception,[3] and this part of the answer by the State is not sustained by the evidence. A quick look at the sections of the Alabama Code immediately preceding the one cited will reveal that there are numerous exceptions of sales transactions from the levy of the Alabama sales tax. A business person in Alabama may engage in a long series of sales transactions of a particular type and not collect taxes from the purchasers, upon an interpretation of the law to the effect that this type of transaction is exempted from the tax; but the State later may successfully assess and collect additional taxes from this business person upon the theory that the statute was misinterpreted and that the transactions were not in fact exempted. There is no hint in this case of a probability that this did not occur here. In such an instance, no taxes would have been collected or withheld from others and not paid over to the State, yet the taxes would be assessed against the business person. The Court finds nothing in the evidence to support this claimed exception to the debts affected by the discharge in bankruptcy. In his brief, the counsel for the State argues that "the State considers the seller to have collected the tax, whether he did or not . . . that these taxes have been collected but have not been paid over nor [sic] remitted and thus are not subject to a discharge in bankruptcy". The hand may be quicker than the eye, but the Court sees and rejects this attempted probative levitation.

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[3] 8 Remington, Bankruptcy, §3315, at 171 (6th ed. 1955)

Finally, we come to the contention, raised only in the State's last brief, to the effect that the tax returns are inaccurate or false per se, because it was later determined that additional taxes were owed by the bankrupt, and that the State's claim is not affected by the bankruptcy discharge, as being for taxes "with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat". The bankruptcy judge doubts that any consideration should be given to this contention because it was not set forth in the State's answer to the complaint. If it is due to be considered, it cannot be the basis for a finding in favor of the State.

It is obvious that the language of this portion of §17 of the Bankruptcy Act is ambiguous. It is arguable that inaccurate or incorrect tax returns are the equivalent of false tax returns; however, the word "false" must in this connotation have an adverb. The question seems to be whether Congress intended to include unintentionally false returns and intentionally false returns or only the latter. If the intention was to include both, there was no need to add "fraudulent" returns. The whole atmosphere of the exceptions to the dischargeability in bankruptcy of taxes, as well as the exceptions in most of the other areas, is to keep the bankruptcy discharge from being available to the grossly dishonest debtor and to keep it from being used to snare creditors. It is not plausible that Congress intended that a quality discharge be granted to the bankrupt who was a tax expert or had one available to him but to grant a second-rate discharge to a taxpayer who, caught up in the swirling intricacies of the tax laws and without expert advice, files a tax return which is later determined to have been based upon an incorrect interpretation of the tax laws.

Some indication that this interpretation by the Court is not pure fantasy may be seen in the fact that this whole subject is dealt with in Collier in one paragraph of three sentences, entitled "Fraudulent Evasion of Taxes".[4] As previously mentioned, it was stipulated that the State does not contend that the

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[4] 1A Collier, Bankruptcy ¶17.14[5] (14th ed., rel. no. 17-1973)

bankrupt's returns were fraudulent or that he made a deliberate attempt to defraud the State.

In view of the foregoing, the Court concludes that the sales taxes (with applicable interest and penalties) for the month of August 1968 and earlier are barred by the discharge in bankruptcy, that the sales taxes (with applicable interest and penalties) for the months of September through December 1968 are not barred by the discharge in bankruptcy, that no judgment can be rendered for the portion which accrued during the period of September 1 through October 14, 1968, because of a total absence of proof of this amount, and that the State is entitled to a judgment against the plaintiff for the sum of $300.00, being the amount which the parties agreed to allocate to the period beginning October 14, 1968, and running through December 31, 1968.

ORDER OF THE COURT

For good cause shown or found, it is ORDERED by the Court that a judgment shall be entered in favor of the State of Alabama (State Department of Revenue) and against John David Fox, Jr. for the sum of $300.00, that this sum is adjudged to be nondischargeable in this bankruptcy proceeding, that the balance of the claim by the State of Alabama (State Department of Revenue) against the bankrupt, John David Fox, Jr., is adjudged dischargeable in bankruptcy and barred by the order of discharge granted to him in this bankruptcy case, that, except for said judgment, Charles A. Boswell, as Commissioner of Revenue of the State of Alabama, and the other officers, agents, or employees of the State of Alabama with notice or knowledge of this order are restrained and prohibited from taking any step or participating in any effort to enforce said claim against the said John David Fox, Jr., except through this bankruptcy case, and that a copy of this order and a copy of said judgment shall be sent through the United States mails to the plaintiff's attorney and to the defendants' attorney, respectively, which shall be sufficient service and notice of that judgment and of this order.

Done at Anniston, Alabama, on this May 20, 1977.

L. CHANDLER WATSON, JR.
Bankruptcy Judge

jw

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

IN RE:	
JOHN DAVID FOX, JR., (Formerly dba Cherokee Construction Company and Cherokee Woodwork and Supply Company, Bankrupt-Appellee.	IN BANKRUPTCY 12780-E
ALABAMA DEPARTMENT OF REVENUE and CHARLES E. BOXWELL as Commissioner of Revenue, State of Alabama, Appellant;	CIVIL ACTION 77-A-0854-E
Vs.	
JOHN DAVID FOX, JR., Formerly d/b/a Cherokee Construction Company and Cherokee Woodwork and Supply Company, Bankrupt, Appellee.	

FILED IN CLERK'S OFFICE
NORTHERN DISTRICT OF ALABAMA

SEP 20 1977

JAMES R. McCORMICK, CLERK
UNITED STATES DISTRICT COURT
By: Jane W. Reed

ORDER

Pursuant to the memorandum opinion filed contemporaneously herewith,

It is ORDERED, ADJUDGED and DECREED that the judgment of the Bankruptcy Judge be and the same hereby is AFFIRMED.

Done, this the 20th day of September, 1977.

UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

IN RE:	)	
	)	
JOHN DAVID FOX, JR., (Formerly dba Cherokee Construction Company and Cherokee Woodwork and Supply Company,	)	
Bankrupt-Appellee.	)	IN BANKRUPTCY 12780-E
ALABAMA DEPARTMENT OF REVENUE and CHARLES E. BOSWELL as Commissioner of Revenue, State of Alabama,	)	CIVIL ACTION 77-A-0854-E
Appellant;	)	
Vs.	)	
JOHN DAVID FOX, JR., Formerly d/b/a Cherokee Construction Company and Cherokee Woodwork and Supply Company, Bankrupt,	)	
Appellee.	)	

FILED IN CLERK'S OFFICE
NORTHERN DISTRICT OF ALABAMA
SEP 20 1977
JAMES T. MANASCO, CLERK
UNITED STATES DISTRICT COURT
BY:

MEMORANDUM OPINION

This case is before the Court on appeal from the Bankruptcy Judge's ruling that certain sales taxes were dischargeable in bankruptcy. The bankrupt, John David Fox, Jr., filed his petition in bankruptcy on October 14, 1971, and was discharged in due course on February 3, 1972. The State of Alabama was a listed creditor and filed its claim on November 22, 1971. The State of Alabama began proceedings to collect the amount alleged to be due subsequent to the granting of the discharge. The bankrupt petitioned the Court to reopen this case and the case was reopened on April 15, 1976, and the bankrupt filed a complaint seeking an adjudication that the claim of the State

of Alabama for unpaid sales taxes was barred by his discharge in bankruptcy granted on February 3, 1972.

The State answered the complaint contending that the debt was not dischargeable in bankruptcy for two reasons:

> "1. The debt represents taxes for which a final assessment was made within three years preceding bankruptcy, bringing it within an exception to the discharge of taxes which became legally due and owing by the bankrupt to the State within three years preceding bankruptcy; and
>
> "2. The debt represents sales taxes collected by the bankrupt from parties who made purchases from him and falls within an exception from the discharge of taxes collected or withheld from others as required by the laws of the State but which were not paid over to it."

In addition, the State raised, in its brief, a third reason why the taxes were not dischargeable by asserting that the bankrupt had filed a false return.

The taxes were assessed on November 7, 1969, after an audit of the books and records of the bankrupt for the period from January 1, 1966, through August 31, 1969. The State concedes that no taxes are due for any period subsequent to December 31, 1968. The bankrupt agrees that his discharge does not bar collection of sales taxes which became due between October 14, 1968, and December 31, 1968, and the parties have stipulated that the amount due for this period is $300.00. The Bankruptcy Judge entered judgment for the State of Alabama for $300.00 and further found that the balance of the State's claim for unpaid sales taxes was barred by the discharge in bankruptcy granted the bankrupt on February 3, 1972.

The taxes involved are sales taxes. The Alabama statutes are found in *Code of Alabama*, Title 51, Sections

786(2) through 786(36). These provisions provide, among other things, that a retail seller must, on or before the twentieth day of the month next succeeding the month in which the tax accrues, file a statement of gross sales for the next preceding month and shall at the same time compute the taxes due and pay same to the Department of Revenue. In other words, the return is due and the tax is payable on the twentieth day of the month following the month in which the liability accrues.

The portion of the Bankruptcy Act involved is found in Section 17a(1); 11 U.S.C. Section 35a(1):

> "A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes . . . (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . ."

The provisions quoted are the pertinent portions of a 1966 amendment to the Bankruptcy Act which, for the first time, made taxes dischargeable in bankruptcy. The taxes in question, therefore, are dischargeable in bankruptcy unless they fall into one of the exceptions provided in the quoted portion of Section 17 set out above. We are faced here with attempting to determine Congressional intent in the enactment of Section 17a(1), 17a(1)(d) and 17a(1)(e). As the Fifth Circuit Court of Appeals said in *In Re Indian Lake Estates,* 428 F. 2d 319,

320, (5th Cir., 1970), when faced with the same problem as to Section 17a(1)(c):

> "This mortal Court must attempt to divine the intent of Congress in a situation where that intent may well be known only to the Divine."

The State first contends that the sales taxes in question became legally due and owing within three years of bankruptcy because they were finally assessed in November of 1969 which was within three years of bankruptcy which occurred on October 14, 1971, and, therefore, are not dischargeable in bankruptcy. The trial judge found that the taxes became legally due and owing on the 20th day of the month next succeeding the month in which the taxes accrued. The next succeeding 20th day of the month is the time by which a retail seller is required to file his statement (return) and pay the taxes called for. The trial court, therefore, found that all sales taxes which accrued prior to September of 1968 were discharged.

The question involved is what is meant by the term "legally due and owing" as it is used in Section 17a(1) of the Bankruptcy Act. The State contends that these taxes became legally due and owing when the State made its final assessment in November of 1969. The bankrupt contends that the taxes became legally due and owing on the date the returns were required and the taxes were payable. *Collier on Bankruptcy* points out that there was an attempt in Congress to define "legally due and owing" as the time when taxes were assessed but this view was not adopted. *Collier* further suggests that the term should mean when the returns are due and the taxes payable. *Collier on Bankruptcy*, ¶17.14, pp. 1614-15.

This Circuit has directly adopted the approach urged by the bankrupt. *In Re Able Roofing & Sheet Metal Company*, 425 F. 2d 699, (5th Circuit, 1970). Justice Jones, speaking for the Court in interpreting the term "legally due and owing," said:

> "If the claim of the United States is for a tax based upon and measured by the income of the taxpayer for the years 1960 and 1961, the taxes for those years were "legally due and owing" not later than April 15, 1961, and April 15, 1962, respectively."

The Court cited with favor *In the Matter of Kopf*, 299 F. Supp. 182. In this case, a referee in bankruptcy held that federal income taxes were "legally due and owing" on December 31st of the year during which the liability accrued. The district court reversed, holding that the taxes were "legally due and owing" on April 15th of the year following the year in which the liability accrued and quoted Senator Ervin's remarks made on the floor of the Senate during debate over the proposed 1966 amendment to the Bankruptcy Act:

> ". . . and when taxes are due on April 15, they are due and owing on April 15, unless the Internal Revenue Service grants an extension."

The taxes here which were due for all months prior to September of 1968 were "legally due and owing" more than three years before bankruptcy because returns or statements of gross sales and payment of the taxes required were all due by Alabama law prior to October 13, 1968, which was exactly three years prior to bankruptcy. "Legally due and owing," as used in Section 17a(1) of the Bankruptcy Act, means when returns are due and taxes payable.

The State next contends that, even though the court

might find that the taxes were legally due and owing more than three years prior to bankruptcy, the taxes are nevertheless not dischargeable because they are taxes which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; thus meeting the exception requirements of Section 17a(1)(e) of the Bankruptcy Act.

The Trial Court held that the State had not sustained the burden of proof as to this contention and points out that there exist numerous exceptions of sales transactions which are exempt from sales tax levy under the Alabama sales tax statutes and that there is no proof before the Court that such sales might not have occurred here. Had the bankrupt misinterpreted the law and failed to collect sales taxes, he would later be liable for payment of the appropriate tax after audit disclosed his misinterpretation. No tax would have been collected or withheld from others and not paid over, and still the liability to pay the proper tax would have, and perhaps did, fall upon the bankrupt. The stipulation of facts on which this case was submitted to the trial judge contains no statement that the taxpayer collected or withheld any sum and failed to pay same over to the State. The stipulation says only that, after audit, it was determined that the taxpayer had understated and failed to report an additional amount of sales tax and that the act of the bankrupt in so doing was not intended as a deliberate attempt to defraud the Department of Revenue. For aught that appears, the bankrupt collected or withheld nothing that should have been paid over to the State of Alabama. The record avail-

able does not support the State's contention that the bankrupt, in fact, did collect or withhold and fail to pay over. The burden of proof is on the State and the finding of the trial judge that the State failed to carry this burden certainly is not clearly erroneous. If not clearly erroneous, this Court cannot disturb the finding of fact made by the trial judge. *Bankruptcy Rule 810.*

There is an even stronger reason why the State's position that sales taxes are taxes "collected or withheld and not paid over" should be rejected. Section 17a(1)(e) appears to have been designed to bar from discharge any indebtedness due a taxing instrumentality for failure to pay over income taxes, social security taxes or unemployment insurance taxes which were deducted from the income or wages of a specific taxpayer. This Court does not think that Congress intended this section to bar discharge for sales tax which the State says are "held" to have been collected, whether they were, in fact, collected or not. The Alabama sales tax is a tax on gross sales and the taxpayer is the retail seller. True, the tax is passed on to the purchaser but it is the retail seller who has the obligation of paying the tax, whether collected from the purchaser or not. Section 17a(1)(e) was never intended to bar a discharge as to sales taxes, but only to bar discharge for failure to pay over income taxes, social security taxes and unemployment insurance taxes deducted from the wages or income of specific, identifiable, third-party taxpayers. *Collier on Bankruptcy*, ¶17.14, pp. 1622-23.

In its brief filed with the trial court, the State of

Alabama raised a third ground for finding the debt here involved to be non-dischargeable in bankruptcy. The State takes the position that the bankrupt filed "false" returns and that Section 17a(1)(d) bars a discharge for taxes with respect to which the bankrupt made a false return. The ninth stipulation of fact contained in the "Stipulation of Facts" on which the case was submitted to the trial judge reads:

> "9. The Department of Revenue does not contend that the Taxpayer-Bankrupt's returns were fraudulent or that there was a deliberate attempt on the part of the Taxpayer-Bankrupt to defraud the Department of Revenue."

The State contends that the word "false" as used in Section 17a(1)(d) means, not only an act done deliberately with intention to mislead, but also the filing of any return which proves to be incorrect for some reason. The trial judge rejected such a contention and held that Congress had intended the word "false" as used in Section 17a(1)(d) to mean a deliberate act calculated to defraud. The trial judge found what this Court considers the section to mean. While there is sparse data available as to Congressional intent in the use of the word "false" in the Section under consideration, an overall examination of Section 17a(1)(d) would indicate that, if Congress intended "false" to mean any inaccurate or incorrect return, then the use of the words "or fraudulent" immediately thereafter is not necessary and is redundant. Bankruptcy Judge Dean M. Gandy of the Northern District of Texas faced this exact question and concluded that a "false" return requires conscious intent to deceive. *In Re Lloyd James Durensky*, 2 Bankr. Ct. Dec. 1212. This Court agrees that "false," as

used in Section 17a(1)(d) of the Bankruptcy Act, must be interpreted to involve a conscious, deliberate intent to deceive and does not intend that every tax liability involving an inaccurate or incorrect return should be held to be a debt not affected by a discharge in Bankruptcy. To hold otherwise would swim upstream against the very purpose of the Bankruptcy Act which strives to give a fresh start to honest, but unfortunate, debtors.

The Court concludes that all sales taxes due by the bankrupt to the State of Alabama, with the exception of taxes due for September, October, November and December of 1968, were discharged in bankruptcy and that the judgment of the bankruptcy judge should be, and is, hereby affirmed.

DONE at Birmingham, Alabama, this the 20th day of September, 1977.

UNITED STATES DISTRICT JUDGE

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
EASTERN DIVISION

IN THE MATTER OF	§	
JOHN DAVID FOX, JR., d/b/a Cherokee Construction Co., & Cherokee Woodwork & Supply Co.,	§	
Plaintiff	§	
v.	§	BANKRUPTCY NO. 12,780
ALABAMA DEPARTMENT OF REVENUE and CHARLES A. BOSWELL, as Commissioner of Revenue, State of Alabama,	§	
Defendants	§	

STIPULATION OF FACTS

1. John David Fox Jr., Bankrupt, d/b/a Cherokee Construction Co. and Cherokee Woodwork & Supply Co., filed a Petition in Bankruptcy on October 14, 1971, and was adjudicated a Bankrupt and discharged on February 3, 1972.

2. The Bankrupt filed sales tax returns with the Department of Revenue for each and every month beginning January 1, 1966 and ending August 31, 1969, as a result of engaging in the business of selling tangible personal property at retail in Alabama.

3. On October 29, 1969, the Department of Revenue made an examination of John David Fox Jr., and his books as provided by Title 51, Section 786(21) Code of Alabama 1940, recompiled 1958, as amended; the taxpayer did not object to the correctness of the examination.

4. As a result of the above mentioned sales tax audit it was determined by the Department of Revenue that the Taxpayer-Bankrupt had understated and failed to report an additional sales tax amount due and owing the State of Alabama of $3,439.27.

5. On November 7, 1969, a Final Assessment of Sales Tax and Notice Thereof was entered against John David Fox Jr., including penalty and interest in the amount of $4,331.15.

6. The Taxpayer-Bankrupt admits that he is presently liable to the Department of Revenue for sales tax due and owing for the period October 14, 1968 through December 31, 1968 and that the parties have agreed to limit the amount for this period to $300.00 (three hundred dollars).

7. During the conduct of the above mentioned sales tax audit, the Department of Revenue determined that the Taxpayer-Bankrupt had overpaid the sales tax due and owing the State of Alabama in the amount of $257.75, and that a credit for the period January 1, 1969 through August 31, 1969 in the amount of $257.75 was included in the audit and deducted from the amount determined to be due and owing the State of Alabama.

8. The amount presently in contention between the two parties is the amount of the Final Assessment, to-wit: $4,331.15.

9. The Department of Revenue does not contend that the Taxpayer-Bankrupt's returns were fraudulent or that there was a deliberate attempt on the part of the Taxpayer-Bankrupt to defraud the Department of Revenue.

The undersigned, attorneys of record for the parties in this action, agree and stipulate that these are the pertinent facts to the determination of the questions presented in this matter.

WILLIAM J. BAXLEY, Attorney General
State of Alabama

WILLARD W. LIVINGSTON, Counsel
Department of Revenue and Assistant
Attorney General, State of Alabama

JOHN J. BRECKENRIDGE, Assistant Counsel
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201 Administrative Building
Montgomery, Alabama 36130

As Counsel for Alabama Department
of Revenue and Charles A. Boswell, Defendants

HERBERT D. JONES, JR.
Burnham, Klinefelter, Halsey & Love

As Counsel For John David Fox, Jr.
Plaintiff-Bankrupt

JUN 17 1980
MICHAEL RODAK, JR., CLERK

In the Supreme Court
of the United States
OCTOBER TERM, 1979
No. 79-1552

ALABAMA DEPARTMENT OF REVENUE, *et al*,
Petitioners

-v.-

JOHN DAVID FOX, JR., *etc.*
Respondent

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RESPONSE OF RESPONDENT TO APPLICATION FOR WRIT OF CERTIORARI

HERBERT D. JONES, JR.
BURNHAM, KLINEFELTER, HALSEY & LOVE, P.C.
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ANNISTON, AL 36202
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Attorneys for Respondent

HIGGINBOTHAM, INC., ANNISTON, AL

In the Supreme Court

of the United States

OCTOBER TERM, 1979

No. 79-1552

ALABAMA DEPARTMENT OF REVENUE, *et al*,
Petitioners

-v.-

JOHN DAVID FOX, JR., *etc.*
Respondent

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RESPONSE OF RESPONDENT TO APPLICATION FOR WRIT OF CERTIORARI

Petitioners have asked this Court to review and reverse the decision rendered in this matter by the United States Court of Appeals for the Fifth Circuit. That opinion is reported at 609 F. 2d 178 (5th Cir. 1980) and is reprinted as appendix A of petitioners' petition. The ground advanced for granting the writ is that the Fifth Circuit's decision is in conflict with the holding of this Court in *United States v. Sotelo*, 436 U.S. 268, 98 S. Ct. 1795, 56 L.Ed. 2d 275 (1978). For the reasons expressed below, the respondent feels that the decisions are not in conflict.

The issue presented is whether a state created statutory presumption that a tax was collected from others is binding on a bankruptcy court applying §17a (1) (e). If it is, then a withholding tax, even if it is not in fact withheld (for whatever innocent reason), can never be discharged so long as the taxing authority puts a presumption of collection in the statute.

Section 17a (1) of the Bankruptcy Act (11 U.S.C. §35a (1)) was enacted by Congress in 1966 to allow debtors, for the first time, to obtain a discharge of tax obligations in bankruptcy. In pertinent part, it provides:

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: Provided, however, That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) *which the bankrupt has collected or withheld from others*

> *as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . .* [emphasis added]

Though the issue was contested in the Bankruptcy and District courts, the petitioners seem now to concede that the taxes involved here were "legally due and owing" for more than three years prior to bankruptcy. Petitioners confine their objection to discharge on subsection (e) contending that the Alabama sales taxes at issue were collected or withheld from others.

The Alabama sales tax provisions which bear on this question impose the tax as a license or privilege tax on the retailer and require that it be passed on to the consumer.

> *Code of Alabama*, 1975, §40-23-2[1] provides:
>
> There is hereby levied, in addition to all other taxes of every kind now imposed by law, and shall be collected as herein provided, a privilege or license tax against the person on account of the business activities and in the amount to be determined by the application of rates against gross sales, or gross receipts, as the case may be . . .
>
> *Code of Alabama*, 1975, §40-23-2[2] provides:
>
> Every person, firm corporation, association or copartnership engaged in or continuing within this state in the business for which a license or

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[1]At the time of the bankrupt's operations and of his bankruptcy, the quoted statute was found in *Code of Alabama*, 1940, Tit. 51 § 786 (3) (Recomp. 1958). There were amendments to the statute not relevant to this case.

[2]Formerly, *Code of Alabama*, 1940, Tit. 51 § 786 (25) (Recomp. 1958). There were various amendments which do not affect the substance of the provision.

> privilege tax is required by this division shall add to the sales price and collect from the purchaser on all sales upon the gross receipts or gross proceeds of which there is levied by this division a sales tax at the rate of four percent, $.04 tax for each whole dollar of sales price . . . The provisions of this section that there shall be added to the sales price and collected from the purchaser the amounts provided herein shall in no way relieve the person, firm, corporation, association or copartnership described in this section of the tax levied by this article; nor shall the inability, impracticability, refusal or failure to add to the sales price and collect from the purchaser the amounts provided herein relieve such person, firm, corporation, association or copartnership from the tax levied by this division. All taxes paid in pursuance to this division or any other statute enacted in this connection shall conclusively be presumed to be a direct tax on the retail consumer, precollected for the purpose of convenience and facility only.

In the instant case, there is no evidence that the bankrupt actually collected from customers the amount called for by the statute. The petitioner relies instead on the legal fiction that the tax is on the ultimate retail consumer, and the retailer is held to have collected it "for the purpose of convenience and facility."

This is not the situation found by this court in *Sotelo*. That case involved the question of whether a responsible person under IRC §6672 could obtain a bankruptcy discharge of his liabilities under that section. The Court held that he could not. Though the §6672 penalty may be imposed on an individual for

failing to collect the taxes, the Court did not address the question of whether a penalty tax could be discharged when it was imposed merely for failure to collect. The court specifically pointed out that:

> . . . It is undisputed here, moreover, that the taxes in question were "collected or withheld" from the corporation's employees and that the taxes, though collected, have not been "paid over" to the government . . .

436 U. S. at _____, 98 S. Ct. at 1800, 56 L.Ed. 2d at _____.

And, also in disposing of the argument that the sum involved in *Sotelo* was a penalty not a tax the Court noted:

> . . . The funds here involved were unquestionably "taxes" at the time they were "collected or withheld from others . . . " It is this time period that §17 (a) (1) (e) with its modification of "taxes" by the phrase, "collected or withheld," treats as the relevant one. That the funds due are referred to as a "penalty" when the government later seeks to recover them does not alter their essential character as taxes for the purposes of the Bankruptcy Act, *at least in a case in which, as here, the §6672 liability is predicated on a failure to pay over, rather than a failure initially to collect the taxes.* [emphasis added, citations omitted]
>
> *Id.*

The Bankrupt's position is that the *Sotelo* result would have been different if Mr. Sotelo's liability was being predicated on his failure to withhold rather than his failure to pay over the funds collected. The differences in the two situations are reflected in the legislative history of §17a (1). In discussing S. Rep.

No. 114, 89th Cong. 1st Sess. (1965), this Court pointed out in *Sotelo* that §17a (1) (e) as finally enacted was to meet the Treasury's objection that it was "most undesirable to permit persons who are charged with the responsibility of paying over to the Federal Government monies collected from third persons to be relieved of their obligations in bankruptcy when they have converted such monies for their own use."

This Treasury objection to an unlimited discharge illustrates a major distinction. When a businessman collects a tax for the government and rather than paying it over converts it to his use, there is an element of embezzlement and breach of trust which ought not be permitted. On the other hand, when the tax is never collected in the first place, this element of culpability is lacking.

A similar distinction is recognized in COLLIER ON BANKRUPTCY, 14th Ed., ¶17.14 [6], pp 1622-23:

> . . . The distinction should be made here between the tax that is imposed and the tax that is to be collected or withheld. For example, if the employer's share of the social security tax is imposed, it would not fall within this exception; however, the employee's share collected by the employer and not turned over, would fall within this exception.

Under the tax system adopted by Alabama in *Code of Alabama*, 1975, §§40-23-2 and 40-23-26, the tax should be passed on to the consumer. If it is, then under the Court of Appeals' holding, it is a tax collected from others and falls within the exception found in 17a (1) (e). On the other hand, if it is not in fact collected from the consumer under §40-23-26, then the merchant is liable to the state for a license or privilege tax under §40-23-2. This is a tax which may be discharged in bankruptcy under §17a (1) (e).

CONCLUSION

For the foregoing reasons, Respondent respectfully urges that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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PROOF OF SERVICE

I, Herbert D. Jones, Jr., counsel for Respondent and a member of the Bar of the Supreme Court of the United States, certify that I have served three copies of the foregoing brief on the Honorable John J. Breckenridge, Assistant Counsel, Department of Revenue, and Assistant Attorney General, State of Alabama, 201 Administrative Building, Montgomery, Alabama, as counsel for Petitioner, by placing the same in the United States mail, postage prepaid on the 13 day of June, 1980.

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